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Dispute resolution/arbitration in tax treaty disputes*

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I. State of play under the available model conventions

1. Neither the current United Nations Model Double Taxation Convention between Developed and Developing Countries (New York, 2001; hereafter "United Nations Model" or "United Nations Commentary", as the case may be) nor the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital (OECD Committee on Fiscal Affairs, condensed version, 15 July 2005; hereafter "OECD Model" or "OECD Commentary", as the case may be) provide for a clause on arbitration in tax treaty disputes in their texts.

2. As mentioned in paragraph 8 of the United Nations Commentary on article 25, the Ad Hoc Group of Experts, in its report on its 7th meeting in 1995, stated the following:

> "With regard to dispute resolution: greater cooperation must be the goal of the Ad Hoc Group of Experts and other multinational institutions. Resolution of transfer-pricing disputes may increase international investment by assuring investors that they will not be subject to double taxation because of inconsistent and incorrect transfer prices imposed by different countries. So far, most countries have refused to cede their authority to any sort of arbitration that is outside the formal jurisdiction of the countries involved. It is proposed that the experience of such arbitrations, where they are authorized, be studied. It may be appropriate in the future for the Ad Hoc Group of Experts to initiate study of bilateral or multilateral approaches to dispute resolution (mandatory arbitration, voluntary arbitration or mediation). At present, countries may consider, in bilateral negotiations, an arbitration provision or other dispute resolution provision within the mutual agreement procedure".

3. The OECD Commentary considers the interaction of the mutual agreement procedure with the dispute resolution mechanism provided by the General Agreement on Trade in Services or with other bilateral or multilateral agreements related to trade or investment (paras. 44.1-44.7 of the Commentary on article 25). Paragraph 48 of the Commentary on article 25 further states the following:

> "Another solution is that of arbitration. This is the solution adopted by the Member States of the European Communities through their multilateral Arbitration Convention, which was signed on 23 July 1990 and which provides that certain cases of double taxation that have not been solved through the mutual agreement procedure must be submitted to an arbitration procedure. Also, some recent bilateral conventions provide that the Contracting States may agree to submit unresolved disagreements to arbitration."

II. Work in progress in the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development

4. Within the OECD Committee on Fiscal Affairs, the Joint Working Group on Dispute Resolution for Working Party No. 1 and Working Party No. 6 took up work on 24 and 25 February 2003. It organized two consultations with representatives from business, the most recent one on 13 March 2006, and held its 7th meeting on

12 and 13 September 2006. A progress report entitled "Improving the Process for Resolving International Tax Disputes", including 31 proposals aimed at improving the way that tax treaty disputes are resolved through the mutual agreement procedure, was released to the public on 27 July 2004 (available at: http://www.oecd.org/dataoecd/44/6/33629447.pdf).

5. The work of the Joint Working Group is twofold, in that it seeks to provide guidance for improving the mutual agreement procedure and to propose the use of supplementary dispute resolution mechanisms, in particular arbitration, to resolve issues that prevent competent authorities from reaching a mutual agreement.

6. At the level of improving mutual agreement procedures, a Manual on Effective Mutual Agreement Procedures is under preparation which will outline stages and timelines of the mutual agreement procedure process and highlight the best practices of the competent authorities of the OECD member countries. A supporting measure is the inclusion of a series of country profiles on mutual agreement procedures on the OECD website, with information about the specific practices of both OECD and non-OECD countries (the country profiles can be consulted at: http://www.oecd.org./document/31/0,2340,en_2649_33747_29601439_1_1_1_1,00.html).

7. The Joint Working Group is also working on an approach to supplement the mutual agreement procedure process where it does not lead to a resolution of particular mutual agreement procedure cases. The addition of a new paragraph 5 to article 25 of the OECD Model providing for mandatory resolution is under discussion. It may read as follows:

> "5. Where, under paragraph 1, a person has presented a case to the competent authority of a Contracting State and the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if any person directly affected by the case is still entitled, under the domestic law of either State, to have courts or administrative tribunals of that State decide the same issues or if a decision on the same issues has already been rendered by such a court or administrative tribunal. The arbitration decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph".[1]

8. Extensive new Commentary is to examine the possible contents of the procedural mutual agreement that would provide for the details of the application of the mandatory supplementary dispute resolution process (i.e. arbitration). In addition, the Commentary would indicate that countries could use such a procedural

[1] In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some countries may only wish to include this paragraph in treaties with certain countries. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph [46] of the Commentary on the paragraph.

agreement to implement a process of supplementary dispute resolution under the existing wording of article 25, which is found in most existing treaties.

9. Current discussions of the Joint Working Group focus particularly on (a) the scope of arbitration and the arbitration award in the tax treaty context, (b) the protection of taxpayers' expectation of an outcome that will prevent double taxation (taxpayers are requested to waive domestic judicial rights) and (c) default provisions to answer what happens if, for a particular mutual agreement procedure, case arbitration cannot be initiated because the competent authorities involved are unable to reach an agreement about what the unresolved issues of the case are. Furthermore, a number of procedural details of the arbitration process are also under consideration.

10. Mediation has equally been contemplated as another possible means of supplementary dispute resolution. While acknowledging that mediation can be a potentially suitable mechanism under given circumstances in a particular bilateral treaty situation, the Joint Working Group is concentrating its work on the arbitration process that can produce binding effects and ensure the resolution of unresolved mutual agreement procedure cases in a more general way.

III. Arbitration clauses in bilateral tax conventions

11. Some countries have made it their policy to propose to selected or all partner States clauses providing for arbitration in unresolved mutual agreement procedure cases when they negotiate or renegotiate bilateral tax conventions.

12. Tax treaties which feature arbitration clauses frequently provide that the agreement of both competent authorities and the taxpayer is necessary to trigger the arbitration process and require, furthermore, that a preceding exchange of notes between the treaty partner States is needed to establish the procedures. For example, paragraph 6 of article XXVI of the Convention between the United States of America and Canada with respect to taxes on income and on capital, as signed on 26 September 1980 and amended, reads as follows:

> "6. If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be resolved by the competent authorities pursuant to the preceding paragraphs of this article, the case may, if both competent authorities and the taxpayer agree, be submitted for arbitration, provided that the taxpayer agrees in writing to be bound by the decision of the arbitration board. The decision of the arbitration board in a particular case shall be binding on both States with respect to that case. The procedures shall be established in an exchange of notes between the Contracting States. The provisions of this paragraph shall have effect after the Contracting States have so agreed through an exchange of notes."

13. It seems fair to say that between States whose tax treaties have arbitration clauses of the type shown under paragraph 12 above, practical experience with the arbitration process is still very limited or missing. It appears that agreements have not yet been made often between contracting States, in the form of an exchange of notes or otherwise, to effectively implement arbitration procedures on the basis of existing treaty provisions.

14. A peculiar arbitration provision can be found in paragraph 5 of article 25 of the Convention between the Federal Republic of Germany and the Republic of Austria for the avoidance of double taxation with respect to taxes on income and capital and to trade tax and land tax, as signed on 24 August 2000. It reads as follows (unofficial English translation):

> "5. If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be removed by the competent authorities by the use of the mutual agreement procedure as provided for by the foregoing paragraphs of this article within a period of three years from the date of initiation of the procedure, the States, upon application of a person covered by paragraph 1, shall be obliged to refer the case to arbitration proceedings before the European Court of Justice pursuant to Article 239 of the European Community treaty."

15. The foregoing provision needs to be contemplated in a European Union context, as both Germany and Austria are States members of the European Union and as such also signatories to the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (see sect. IV below).

IV. Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, concluded between the Contracting Parties to the Treaty establishing the European Community, of 23 July 1990

16. The Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC; hereafter the "EC Arbitration Convention") is currently the world's flagship of the arbitration process for tax treaty disputes. Within the Convention's framework, transfer pricing cases that remain unresolved in mutual agreement procedure for two years are referred to an advisory commission charged with delivering its opinion on the elimination of the double taxation. The advisory commission is to deliver its opinion within six months from the date on which the matter was referred to it. The competent authorities that are party to the arbitration procedure are required to take, acting by common consent, a decision which will eliminate the double taxation within six months of the date on which the advisory commission delivered its opinion. The competent authorities may take a decision that deviates from the advisory commission's opinion. If they fail to reach agreement, they are obliged to act in accordance with that opinion.

17. The Code of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990; hereafter referred to as the "Code of Conduct") is a political commitment of the member States and released by the Council of the European Union. It sets out the procedural guidelines for the implementation of the EC Arbitration Convention.

18. The EC Arbitration Convention and the Code of Conduct are available at: http://europa.eu.int/comm/taxation_customs/taxation/company_tax/transfer_pricing/arbitration_convention/index_en.htm.

V. Business community interest in arbitration for tax treaty disputes

19. Representatives of the international business community have continuously expressed a keen interest in the arbitration process in international tax matters. Notably, the International Chamber of Commerce in Paris released a model Bilateral Convention Article and Commentary (available at: http://www.iccwbo.org/policy/taxation/id501/index.html).

VI. Considering the insertion of an arbitration clause into the United Nations model

20. According to the work undertaken by the OECD Joint Working Group, the fact that the current mutual agreement procedure process does not generally provide for a speedy and concluding outcome which removes double taxation in any individual mutual agreement procedure case may cause taxpayers to hesitate in making the resource commitment to enter into the procedure and likewise provides no incentive to competent authorities to take all steps necessary to ensure a speedy solution to the issues involved. The very existence of arbitration provisions can encourage greater use of the mutual agreement procedure process since both Governments and taxpayers will know at the outset that the time and effort put into the process will be likely to provide a satisfactory result. Arbitration clauses provide competent authorities with a further incentive to ensure that the process is conducted efficiently in order to avoid the necessity of subsequent supplemental procedures.

21. The considerations of the Joint Working Group stated in paragraph 20 seem appropriate also for the relationship between developed and developing countries. In addition, arbitration provisions in tax treaties concluded by developing countries are likely to increase such countries' attractiveness for foreign investors, having effects similar to those of agreements for the protection of investments.